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November 10, 1977

MEMORANDUM

SUBJECT: Factors Affecting Saudi Arabia's Position on an
OPEC Oil Price Increase

Any consideration of strategies aimed at persuading Saudi Arabia to hold the line on oil prices must take into account the following factors:

- Saudi Arabia's determination to avoid another break with OPEC and its reduced leverage over OPEC due to technical production limitations.
- The Saudis' expectation of tangible political results from the US in Middle East peace negotiations.
- The Saudis' belief that modest oil price increases are unavoidable and justified due to market conditions and are a necessary spur to the development of a "responsible" energy program in the US.
- The likelihood that Saudi Arabia, out of concern for the health of Western economies, will continue to lobby for only minimal price increases and periodic freezes so long as Middle East peace negotiations do not collapse.

Given the above factors and the present climate of pessimism in the Arab world over the prospects for a Geneva conference, we believe it highly unlikely that further US demarches to Saudi Arabia aimed at preventing an oil price increase at Caracas would be successful. Prince Fahd told Secretary Blumenthal that the Saudis are prepared to argue initially for a price freeze but he implied that the Saudis would be forced to accept some increase because they could not be sure the other OPEC members would agree to a price freeze. A revised US demarche to Saudi Arabia to hold down

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any increase in oil prices at Caracas would be an unnecessary expenditure of political capital because the Saudis probably would work on their own to hold any price increase to the 5-10 percent range.

Beyond next month, Saudi decisions on oil policy are likely to be primarily influenced by the course of Middle East peace negotiations. The Saudis are unlikely to respond favorably to US demarches for further restraint if they perceive that the US is unwilling to press Israel to meet basic Arab demands in a settlement. The Saudis recognize that only they have the kind of leverage over the West that holds out the hope of budging Israel and their warnings that they will feel forced to use this leverage have become more explicit in the past few months.

The Saudis see a Middle East settlement as vital to their own security. They believe the resolution of the Arab-Israeli dispute is the key to preventing the further spread of radicalism and Soviet influence in the Arab world; in particular, they want to prevent the overthrow of Sadat and Asad. They fear that the fall of the moderate Arab leaders would guarantee another Arab-Israeli war, threatening Saudi oil and security interests. Further, they know the reestablishment of radical regimes in Egypt and Syria would isolate Saudi Arabia as it was in Nasir's day, redoubling the likelihood of externally sponsored subversion.

The Saudis might impose, or threaten to impose, an oil production limitation if there is a sustained period of no movement toward a peace settlement, coupled with an Arab perception that the US is not sufficiently pressuring Israel to reach a political compromise. A production ceiling at a low enough level would have the same economic impact as an embargo on the US and its allies. Riyadh would recognize that any reduction in oil supply to the West must be fine-tuned to avoid world economic and political disaster and yet hurt enough to achieve the desired political results.

The serious technical problems that will further limit Saudi production flexibility after the next year and a half are not a constraint on the Saudis in the context of current efforts to achieve a Middle East settlement. The prospects for either progress in, or the collapse of, negotiations should be clear within the next several months.

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While Saudi Arabia, because of technical difficulties, may no longer be in a position to greatly help the US on oil production and pricing after 1979, it is, and will remain, in a position to hurt the US.

Beyond its ability to pressure Israel for negotiating concessions, the US has no credible defense against a Saudi decision to manipulate its oil leverage in support of Arab political demands. The Saudis, for example, are unlikely to be impressed by a US sponsored attempt to form a consortium of oil-consuming nations to pressure them on oil prices. The Saudis realize that European states are not in a position to apply economic or political pressure on the Arabs for fear of jeopardizing their own oil supplies. Further, they would believe that European nations would not want to be associated with a US policy that they believe lacks credibility. The Saudis are equally unlikely to be impressed by confrontation tactics--such as trying to impose a Western arms embargo on Saudi Arabia--because they know that European nations such as France are unlikely to cooperate.

In light of the above considerations, we believe that further unilateral US or multilateral efforts to impress on the Saudis the damage that would be done to the economies of the Western and less developed countries by oil price increases are unnecessary. The Saudis are already aware of all the arguments that could be made and they fully comprehend the negative effects of even a minimal rise in oil prices.

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